CITY OF LONDON
Investment Management Company Limited

Listed Private Equity (LPE) Update: Board Action Gaining Momentum

May 2024

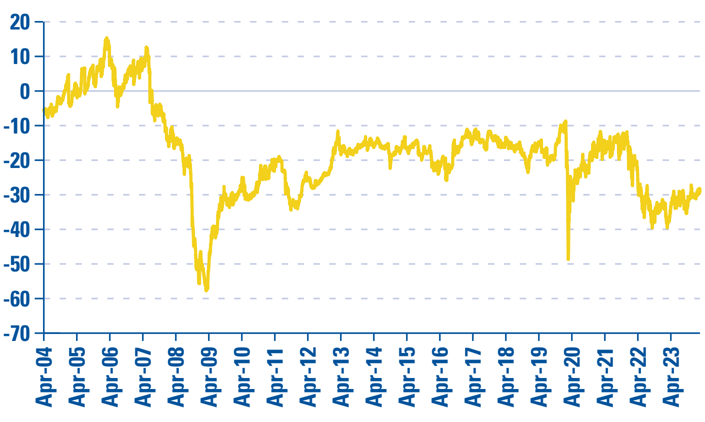
In May 2023 we published a White Paper titled Compelling Cyclical Value in Liquid Private Assets. This discussed utilizing liquid public securities to manage plan allocations to private equity, providing:

- *Effective liquidity and J-Curve management via an access product delivering reliable beta to the sector.*
- *High confidence of outperformance vs. plan hurdle rates as discount to NAV compress from historically wide levels.*

The cyclically compelling entry point still exists.

Listed private equity discounts remain very wide relative to historical averages offering absolute and relative value. Modest narrowing from recent extremes has not significantly impacted the positive asymmetry of current valuations.

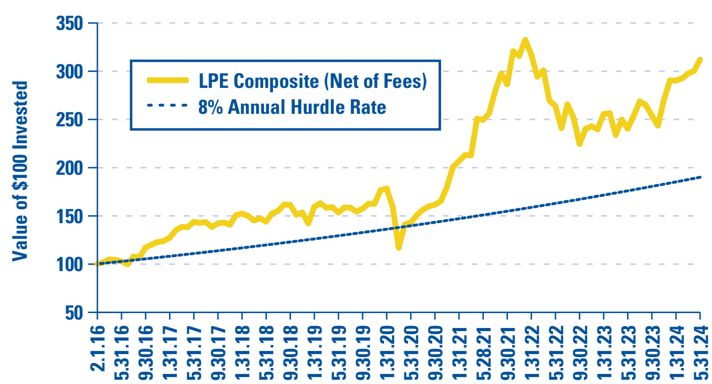
Chart 1: Listed Private Equity Sector Discount ex 3i 20 Years to 28th March 2024



Source: Morningstar

Further, as shown by Chart 2, since the end of May 2023, the Listed Private Equity Composite Net of Fees has gained 29.8% over the 1-year period, comfortably outperforming the gains of 24.9% by the MSCI World Net Total Return Index in US dollar terms. The core ability of the LPE sector to offer returns in line with their unlisted peers through the cycle (and more than public equity) is intact.

Chart 2: Listed Private Equity Composite Since Inception



Composite incepted February 1, 2016. Values as at May 31, 2024.
Net returns are based on a model investment management fee of 0.9% per annum.
Past performance is no guarantee of future results. Please see "Disclosures" for important information.

	1 Year	Annualized 5 Years	Annualized Since Inception
LPE Composite (Net of Fees)	+29.80%	+15.27%	+14.63%
8% Annual Hurdle Rate	+8.00%	+8.00%	+8.00%

Source: CLIM

Why are Listed Private Equity valuations distressed?

Several factors have caused public market share prices to dislocate from private net asset value (NAV) marks, including:

1). Concerns over the robustness of Private Equity valuations and subsequently the NAVs of the Closed-end funds as public markets fell in 2022.
2). The high interest rate environment and the potential impact on Private Equity returns.
3). A slowdown in Private Equity deal flow and muted IPO activity resulting in fewer exit opportunities.
4). Denominator effect amongst generally overweight allocators as Private Equity valuations outperformed listed equity markets in 2022 limited appetite to "buy-the-dip".

Much of the above has been at least partially addressed. Valuations have been relatively stable, as gains in NAVs have mainly been driven by revenue and EBITDA growth, offsetting modest multiple compression, whilst global equity markets have recovered from their 2022 sell off. Global interest rates are stabilizing with some central banks such as the ECB already cutting as inflation rates moderate. Meanwhile there are signs of green shoots in the private equity industry and tentative indications of increasing IPO activity. As noted in the Bain & Company Global Private Equity Report 2024, "Interest Rates appear to have stabilized, record dry power is stacked ready for deployment and nearly half of global buyout companies have been held for at least four years".

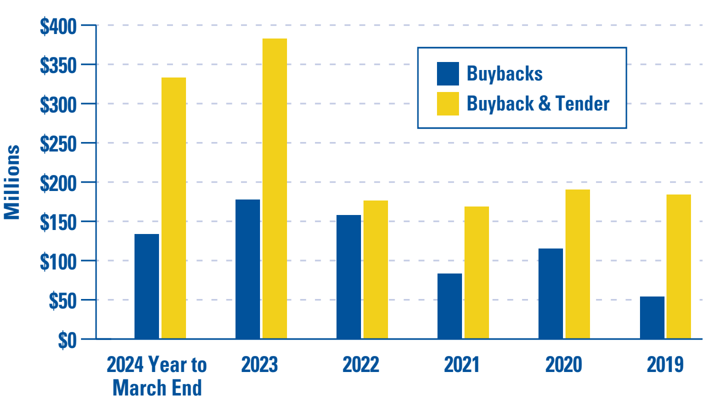
Corporate Activity – The valuation backstop.

Whilst the Private Equity sector backdrop appears to be gradually improving, which may once again improve demand for LPE, what is clearer is the supply side undergoing radical change via Board action.

These positive actions will not only reduce supply of shares, and hence the discount via an improvement in the demand/supply equilibrium but can also lead to an increase in demand as investor confidence is restored. At the very minimum share buybacks enhance NAVs as funds buy back shares accretively. As noted in the Pantheon International interim results ending November 2023, the impact of share buybacks totaling £172.4m at an average 36% discount added 3.8% to the NAV over 6 months.

Corporate activity has always been a feature of the sector, especially during periods of wide discounts with numerous mergers, takeovers, and liquidations. However, with discounts remaining wide since Q1 2022, we have seen a significant increase in Board actions. The catalyst for this activity was probably sparked by Pantheon International in August 2023 when it announced a £200m share buy back as part of an initial package to address the wide discount. This undertaking has placed significant peer pressure on funds across the sector to focus on discount control amid increasing shareholder activism in CEFs in general. Chart 3 shows the impact this has already had, with a significant increase in buybacks since 2023. What is astounding about the 2024 number is that it only reflects one quarter of the year.

Chart 3: Listed Private Equity – Buy Backs Increase Significantly as Discounts Remain Wide



Source: CLIM research

Capital Allocation Policies (CAP) – A new paradigm.

As discounts have remained stubbornly wide, Boards have had to focus on capital allocation policies to restore credibility. Shareholders increasingly demand that these policies are formalized to garner their support. Chart 4 summarizes the policies enacted since we wrote our last paper in May 2023.

Chart 4: Summary of the Latest Capital Allocation Polices (CAP)

Fund	Announcement Date	Capital Allocation Policy (CAP)
Pantheon International	Aug-23	£200m share buy back & formalized share buy back policy funded from realizations calibrated to discount level
Chrysalis Investments	Oct-23	£100m share buy back from realizations, thereafter 25% of net cash profits from realizations to be distributed
Eurazeo	Nov-23	EUR2.3bn to be returned via dividends and buybacks between 2024-7
Harbourvest Private Equity	Feb-24	Distribution pool funded from 15% of cash realisations
Princess Private Equity	Mar-24	Buy backs funded from realizations calibrated to discount level
Petershill Partners	Apr-24	$100m tender offer at 15% premium to share price on announcement date
ICG Enterprise Trust	May-24	Opportunitic buy back programme in addition to long term share buy back and dividend
Apax Global Alpha	May-24	CAP review update planned for June 2024
Molten Ventures	Jun-24	Share buybacks funded from 10% of realizations

Source: CLIM Research, Bloomberg, Company Announcements

Shareholder friendly – and not yet in the price.

Whilst the announcement of new CAPs by several LPEs has had a stabilizing impact on discounts, which will likely limit further discount widening under normal market conditions, we also believe that the new policies are not yet fully reflected in LPE shares' prices. In the very short term, it will take time to make an impact as private equity distributions remain subdued relative to historical averages. However, in the near to medium term activity is expected to pick up which should flow through to portfolios and distributions. There may be concerns that distributions will shrink asset bases. However, we believe that NAV growth will offset distributions as portfolio growth rates return to historical averages of double-digit annualized returns and narrowing discounts act to reduce the level of distributions under the new policies.

The Case for a Structural Investment in LPE remains convincing.

Long-term performance reflects the underlying performance of the limited partnerships in which the listed vehicles invest. In net asset value (NAV) terms the 10 largest UK listed funds in the universe have recorded an average return of 11.6%[1] annualized in USD terms over the past 10 years, comfortably outperforming the MSCI World Net Total Return USD Index gain of 9.2%.

The listed CEF wrapper provides liquidity - transforming an illiquid asset class into an asset with daily pricing and liquidity.

LPE trades at discounts and premiums to NAV, and the discount volatility creates inefficiencies that can be exploited via a dedicated strategy. The entire investor base is seeking exposure to private equity but importantly not all are not discount aware.

The LPE universe offers a solution for investors seeking to mitigate the cashflow/liquidity uncertainty inherent to the asset class and actively manage their PE weighting.

[1]NAV performance calculated using a simple average for the 10 largest funds by market capitalization from the buyout and multi strategy sectors listed on the London Stock Exchange (LSE) for 10 years to 31st December 2023.

Summary

The case to invest in LPE remains very strong:

1. LPE provides liquidity without compromising active returns
2. Boards are getting more assertive with their CAPs as buybacks and tender offers increase
3. J-curve effects are reduced, portfolio vintages have increased
4. LPE funds have delivered long-term NAV returns in line with the underlying LPs
5. Discount trends provide a structural inefficiency which CLIM is uniquely positioned to exploit
6. Wide discounts offer a compelling opportunity today

CLIM has a seasoned team of dedicated CEF investors with a proven track record to exploit this cyclical opportunity.

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